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Foreign and Commonwealth Office

London SW1A 2AH

18 March 1988

Dear Charles,

Yugoslavia: Visit by Mr Djuranovic

Mr Veselin Djuranovic, member of the Yugoslav Federal Presidency, is to call on the Prime Minister at noon on Wednesday 23 March. The call is to last 45 minutes (with interpretation) and will be preceded by a Guard of Honour in the FCO main courtyard at 1140, and followed by a lunch which the Prime Minister has kindly agreed to host. Mr Djuranovic will have seen The Queen on 22 March.

The initiative for this visit came from the Yugoslavs. We agreed to it, partly in order to show continued interest in Yugoslavia (Gorbachev is in Belgrade this week) but mainly because the Yugoslavs have still not grasped the nettle of economic reform. They are well aware of what has been achieved in the UK. The Prime Minister is ideally placed to point out the need for a more resolute effort to free the Yugoslav economy from political and administrative restrictions.

The Prime Minister may therefore wish to concentrate mainly on the Yugoslav internal situation and relations with the IMF and Paris Club; on EC/Yugoslavia; and briefly on bilateral relations, especially the Yugoslav failure to settle British claims following the Zagreb air crash in 1976. Background and a suggested line to take on these are set out below.

Mr Djuranovic for his part will no doubt say something about Gorbachev's visit to Belgrade and the Yugoslav view of East/West relations. He may refer to the activities of Croatian emigres in Britain; to Yugoslavia's current role (this month) as President of the Security Council; suggest bilateral cooperation against terrorism; and refer to the Yugoslav Light Combat Aircraft (LCA) project, and perhaps to a current consular case (involving the Trajkovski twins). Those subjects are also covered briefly below.

Mr Djuranovic will probably invite the Prime Minister to pay another visit to Yugoslavia. The Foreign Secretary does not consider that this would be appropriate while our Zagreb claims remain unsettled. But if that issue can be resolved, he believes a further visit would be useful, in due course. The Prime Minister would be sure of a warm welcome, and the Yugoslavs will need constant high-level encouragement if they are to stick to an appropriate economic programme.

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Yugoslav Internal

Yugoslavia's complex federal structure and collective, rotating leadership, have provided a fragile form of stability since Tito's death, but have also inhibited effective decisions on political and economic reform. The present federal government under Branko Mikulic has failed to get to grips with the problems, and has been widely criticised. Mikulic may serve a second term from May this year, for lack of a willing or credible alternative. There is acute tension in the largely Albanian province of Kosovo.

Economy and Debt

Yugoslavia's net external debt is close to \$20 bn. Despite a current wage/price freeze, inflation is still over 100%. Economic management has been feeble. The essential problems are political: how to reconcile in a single economic programme the contradictory needs of Yugoslavia's republics and regions; and whether the politicians are ready to surrender economic power to the market.

Last September, the Yugoslav authorities announced a programme of 126 measures intended to stabilise the economy. While some of these were on the right lines, the programme as a whole is ill-conceived and inconsistent (the earlier and still current Stabilisation Programme of 1982 is less open to criticism). In late 1987, after nearly two years of "enhanced monitoring" by the IMF (during which most of the IMF's performance criteria were missed) and faced with a financing gap of around \$1 billion in 1988, the Yugoslavs conceded that a Standby Arrangement (SBA) was needed. Discussions are now in progress with the IMF Staff. But there is wide disagreement, especially on the inflation target, interest rates and incomes policy. The British approach is that terms for an SBA should not be softened on political grounds. Most other major Western creditors agree. (Italy is an exception. It has recently offered Yugoslavia grants and low interest loans). However, other major creditors see more risk than we do, if the IMF sticks out for strong conditionality, that Yugoslavia may either suffer damaging instability or drift towards the CMEA and Warsaw Pact.

The Prime Minister may wish to tell Mr Djuranovic that we are concerned about Yugoslavia's deepening economic crisis (though acknowledging some encouraging aspects: exports to hard currency markets increased by 18% in 1987, and to the UK by some 21%). We welcome the Yugoslav decision to seek an SBA. We agree that Yugoslavia needs longer-term restructuring of its debts. Bridging finance (for which Mr Djuranovic may ask) is not the answer. But we will play a constructive part in the Paris Club once an SBA has been agreed. We look to the Yugoslavs to devise and implement market-oriented policies. Things have been allowed to drift since the payments crisis of 1982/3 (when the UK made a £38 m loan, as well as contributing



generously to refinancing). No-one pretends it is easy to make an economy more responsive to the market, or to give better incentives to enterprises. But it will be no service to Yugoslavia if a weak SBA is agreed.

EC/Yugoslavia

Yugoslavia has a Cooperation Agreement with the EC. In February 1987, Mikulic wrote to Community Heads of Government stressing the political importance of the agreement, and pressing for improved treatment. During 1987, new and more favourable trade and financial protocols were negotiated. A resolution in positive terms was adopted by the joint Cooperation Council in December.

The Prime Minister may wish to welcome the new protocols, and underline the political and economic importance of Yugoslavia's relations with the Community. But she could add that better access to Community markets must in the longer term mean greater reciprocity. This in turn underlines the need for a more efficient, market-based Yugoslav economy.

Bilateral Relations

These are in general cordial and substantial, reflecting longstanding ties. Since the Prime Minister's visits to Yugoslavia in 1980, Mikulic's predecessor Mrs Planinc has paid a return visit (1983); the Foreign Secretary has been to Belgrade (1986); the Yugoslav Defence Minister to the UK (1986); and there has been an exchange of visits by Trade Ministers.

An important problem however is the Yugoslavs' failure to settle British claims following a mid-air collision between British and Yugoslav aircraft over Zagreb in 1976. Faulty air traffic control at Zagreb was the main cause of the accident, although the Yugoslavs dispute this. The sum at stake is about £12 m. The bulk of this represents a claim by BA and its insurers for the aircraft, but private claims by relatives of the crew have also not been settled. After protracted legal argument, the Yugoslav courts have this year ruled that BA's claim is time-barred. BA's lawyer has asked for a review of this decision. This is almost certain to be rejected. If it is, the only alternative will be a political settlement, which the Yugoslavs rejected last year but have hinted they may be ready to consider when the legal process is complete.

The Prime Minister may wish to express disquiet that the claims remain unsettled after 12 years; say that the court's recent decision was a major disappointment; that she hopes it will very soon be clear whether the decision will be reviewed; but stress that if it is not, we shall be left with a major political problem. She may wish to invite Mr Djuranovic to comment on a political settlement, and say that action is needed rapidly to clear this important issue off the agenda.



Mr Djuranovic for his part may refer to the following:

i) Activities of Croatian emigres in Britain.

The Yugoslavs recently complained that Croatian emigres in Britain were planning or had been involved in terrorism. Our reply stressed that we had no evidence of any breach of the law in Britain. We drew attention to British traditions of free speech and peaceful political activity.

ii) Bilateral cooperation against terrorism.

The Yugoslavs have several times suggested this. Our response has been that we find cooperation useful in multilateral fields, eg on aircraft security within the European Civil Aviation Conference; but that we do not envisage cooperation at bilateral level. (The reason is that we do not wish to stimulate Yugoslav requests for action against Croatian emigres in Britain).

iii) LCA project.

We have recently told the Yugoslavs that British companies (mainly BAe and Rolls Royce) wish to continue to cooperate on this ambitious project, but that there are four areas where advanced technology cannot be released. The Prime Minister may wish to say, if necessary, that we continue to attach importance to defence cooperation with Yugoslavia including on the LCA project; but that no change in our decision on the four areas can be expected in the timescale the Yugoslavs have indicated for the project.

iv) Trajkovski Twins.

Mrs Trajkovski, a British subject, returned last year from Yugoslavia with her children, who had been abducted by their Yugoslav father. She has obtained a court order in Britain denying access to the children by the father. The Yugoslavs maintain that this cuts across an assurance she gave to a Yugoslav court. We have told them that it is open to the father to contest the order made in this country.

Mr Djuranovic and his interpreter (Miss Brajovic) will be accompanied by the Yugoslav Ambassador, Mr Calovski. Personality notes are attached. Our Ambassador in Belgrade, Mr Wood, will also be present.

Young ones

L Parker

(L Parker)
Private Secretary

C D Powell Esq
PS/No 10 Downing Street



DJURANOVIC, VESELIN

Member for Montenegro of SFRY Presidency. (Five year mandate from 15 May 1984).

Born 1925 near Danilovgrad, Montenegro. Montenegrin.

Party: Partisans 1941. 1943 arrested by Italians and sent to Concentration Camp until 1944. Joined Party 1944. Member of the CC of Montenegrin LC and of its EC 1958. President of Ideological Commission of Montenegrin Party 1958-62. President of Montenegrin SAWP 1962-63. Member of EC of LC Montenegro 1964, and member of Federal CC 1964. President of LC Montenegro 1968. Re-elected 1974. Member of CC LCY 1982-86.

Government: Member of Council of Federation, President of EC Montenegro and President of Montenegrin EC Committee for Defence 1963-67. 1977 President of FEC; re-elected 1978. Also Member of Council for National Defence and of Federal Council for Protection of the Constitutional Order. 1982-83 President of Presidency of SR Montenegro. 1983-84 Member of Montenegrin Presidency.

Djuranovic was appointed the youngest ever Prime Minister in 1977. His time as Prime Minister was one when economic problems came home to roost, though he himself was not generally blamed. In 1982 he returned to Montenegro but was elected to the new SFRY Presidency in 1984 and was its first President (1984-85). He was not a forceful or charismatic President and failed to galvanise the Presidency into action during his term of office. Has been scarcely visible since.

Rather school-masterly. Has trouble with his back. Known by Montenegrins as "Ves o". Has two sons and one daughter. His wife worked in social insurance before retiring. Enjoys watching sport, particularly soccer.



CALOVSKI, MITKO

SFRY Ambassador to the United Kingdom, since May 1985.

Born 1930 in Bitola, in the region of Macedonia. Macedonian. Graduated from Higher Journalist-Diplomatic School in Belgrade 1953.

Member of LCY since 1948.

Has been member of the Committee of the LCY in the Federal Secretariat for Internal Affairs; member of the Communal Council SAWP Vracar in Belgrade; member of the Commission for International Links and Co-operation of the Federal Council of SAWPY; member of Election Commission of Federal Council SAWPY.

In government; Chef de Cabinet of the President of the Federal Council SAWPY; member of the Group of Current Economic Questions of the Federal Council SAWPY; SFRY Consul General in Toronto, Canada; Chief of the Group for Analysis and Planning in the Federal Secretariat for Foreign Affairs; Deputy Secretary of SFRY Presidency; and SFRY Ambassador to Canada.

1982-85 Federal Secretary for Information and Member of FEC.

Energetic and friendly but voluble, self-important and opinionated. Had a reputation as a hard-liner as Federal Secretary for Information.

Speaks good English as does his wife who has taught English literature in a Belgrade school.